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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 147

M. A. HOLMES,

Petitioner,

vs.

CHARLES J. McCOLGAN, AS BANK AND CORPORATION FRANCHISE TAX COMMISSIONER OF THE STATE OF CALIFORNIA.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA AND BRIEF IN SUPPORT THEREOF.

RALPH D. BROWN,
E. H. CONLEY,
Counsel for Petitioner.

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PETITION FOR A WRIT OF CERTIORARI.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, M. A. Holmes, respectfully prays for a writ of certiorari herein to review a certain final decision of the Supreme Court of the State of California, being the highest court of said State, in the above entitled matter, the opinion and decision of said court having been rendered and filed February 20, 1941 (R. 19), and a petition for rehearing having been thereafter denied March 20, 1941 (R. 25). By this decision the said court held that the Fourteenth Amendment to the Constitution of the United States is not violated by the California Personal Income Tax Act of 1935, in imposing an income tax on capital gain *accrued* prior to but *realized* after the applicable date of the Act, and

that therefore the petitioner could not recover an income tax deficiency assessed against him which he paid under protest.

Statement of the Matter Involved.

The California Personal Income Tax Act of 1935 (1935 Cal. Stats., Chap. 329, page 1090) was approved and became effective June 13, 1935, and imposed, for the first time in the State, an income tax on all individual incomes received after January 1, 1935, and with respect to the determination of income from capital gains adopted by reference Sections 111, 112, and 113 of the Federal Revenue Act of 1934. An income tax was thereby imposed on all capital increment (when realized) which accrued prior to the commencement date of the California Act and subsequent to March 1, 1913. Petitioner brought this action to recover a deficiency income tax assessment of $2,137.36 paid by him under protest, imposed, under the California Act, upon the realization of capital increment which had accrued in its entirety prior to the commencement date of the Act.

The constitutional question was originally raised by the complaint (R. 1-17, particularly 7-8) and the general demurrer (R. 17) thereto, necessarily admitting all the facts alleged in the complaint. The Federal right was decided adversely to the petitioner by the judgment of the court of first instance (R. 18) and by the Supreme Court of the State of California in affirming such judgment (R. 25). The opinion of the Supreme Court of the State of California sets forth that there was no increase in the value of the property involved between January 1, 1935, the applicable date of said Personal Income Tax Act and the date of sale thereof (R. 20), but upholds the respondent Franchise Tax Commissioner in treating the difference between the cost of the property and the selling price thereof as taxable

income in spite of the contentions of petitioner set forth in said opinion as follows: That on January 1, 1935, the property constituted a capital asset and that the proceeds from the sale thereof represented a return of capital and not income and that the Act could not be applied to such proceeds without violating the Fourteenth Amendment to the Constitution of the United States (R. 20, 21).

A copy of the opinion of the Supreme Court of the State of California (being the only opinion rendered in this matter) and of the pertinent provisions of the statutes involved are appended to the brief supporting this petition.

Statement of the Basis Upon Which This Court Has Jurisdiction to Review the Judgment in Question.

This cause draws in question the validity of a State statute, to wit: California Personal Income Tax Act of 1935 (Calif. Stats. 1935, Chap. 329, p. 1090) on the ground of its being repugnant to the Fourteenth Amendment to the Constitution of the United States and this Court has jurisdiction to review the same under Section 237(b) of the Judicial Code of the United States. See *Coolidge* v. *Long*, 282 U. S. 582, 75 L. Ed. 562; *Towne* v. *Eisner*, 245 U. S. 418, 62 L. Ed. 372. The decision sought to be reviewed was rendered February 20, 1941 (R. 42 and 52), and a petition for rehearing thereof was denied on March 20, 1941 (R. 53). The time in which a petition for certiorari may be filed is computed from the date of denial of rehearing under *Gypsy Oil Company* v. *Esco*, 275 U. S. 498, 72 L. Ed. 393, and *Citizens Bank of Michigan City* v. *Opperman*, 249 U. S. 448, 63 L. Ed. 701.

Questions Presented.

Two questions are presented under Section 1 of the Fourteenth Amendment to the Constitution of the United States with respect to the retroactive provisions of the Personal

Income Tax Act of 1935 of California that became effective on June 13, 1935 (said Act being the first personal income tax law in the State of California), as such provisions apply to a capital gain that had wholly accrued before January 1, 1935. These two questions are:

1. Is said section violated by the provision of the Act making it apply retroactively to such a capital gain realized on or after January 1, 1935, but before June 13, 1935?

2. Is said section violated by the provision of the Act incorporating by reference sections 111, 112 and 113 of the Federal Revenue Act of 1934, thereby making March 1, 1913, value, or subsequent cost, the basis upon which such capital gain shall be computed?

Reasons Why the Writ of Certiorari Should Issue.

1. The decision of the Supreme Court of the State of California in this case has decided both of the questions presented in the negative. They present Federal questions of substance not heretofore determined by the Supreme Court of the United States.

The California Personal Income Tax Act of 1935 in question was the first personal income tax act in the State, having been enacted June 13, 1935, to tax all personal income received after January 1, 1935. As construed by the California Supreme Court in this matter, the Act taxes as income all capital gain realized after January 1, 1935, although resulting from an enhancement in value during any period subsequent to March 1, 1913, but does not tax a similar gain realized before January 1, 1935. The March 1, 1913, date is arbitrarily adopted through incorporation by reference in the California Act of the United States Revenue Act of 1934 and has no reasonable relation to the inception date of the California tax on incomes. This Court has never heretofore decided whether a State may consti-

tutionally impose an income tax on capital increment accruing before but realized after the applicable date of the first personal income tax law adopted by said State. The decision of this Court in *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 76 L. Ed. 1083 (relied upon in *Fullerton Oil Co.* v. *Johnson*, 2 Cal. (2) 162, 39 Pac. (2) 796, upon which the California Supreme Court bases its decision in the instant case) is not determinative of the matter. In that case the retroactivity of the Revenue Act of 1928, which was there involved, to gains previously accrued was sustained on the theory that Congress had theretofore established a policy of taxing such gains and that there was no attempt to tax the enhancement in value prior to the establishment of such policy.

The decisions of this Court in the gift tax cases are upon an analogous situation. No different principle is involved, they appear to be persuasive, and petitioner submits that they should be followed in this case. The cases referred to are: *Nichols* v. *Coolidge*, 274 U. S. 531, 542, 71 L. Ed. 1184; *Blodgett* v. *Holden*, 275 U. S. 142, 72 L. Ed. 206; *Untermeyer* v. *Anderson*, 276 U. S. 440, 72 L. Ed. 645; and *Coolidge* v. *Long*, 282 U. S. 582, 75 L. Ed. 562.

It is of importance both from the standpoint of administering the Personal Income Tax Act of California and from the standpoint of the taxpayers of California that the Federal questions involved be decided.

2. A decision of the second question presented is of major importance because of the number of States now without personal income tax laws that, under existing economic conditions, will undoubtedly soon be forced to adopt such a law. In adopting such a law and establishing by it a policy of taxing realized capital gains, such States should know how far they can go into the past in fixing a date as a basis from which capital gains may be constitutionally computed

and taxed. Until this question is decided by this Court, such States will be in uncertainty as to whether, if they follow the example set by the State of California and provide that capital gains arising from and after March 1, 1913, may be taxed, such a provision will be constitutional. Petitioner submits that it is in the interest of public welfare that this uncertainty be removed.

3. The decision of the Supreme Court of the State of California in this case results in a conflict between it and the decisions of the courts of last resort of certain States concerning Federal questions of substance, and a decision by this Court is necessary for the purpose of securing uniformity therein.

The decision of the California Supreme Court in this matter indicates that there is no limit to a State's power to impose an income tax on the realization of capital gain accrued before the taxing act was enacted. A contrary conclusion was reached by the Supreme Court of the State of Wisconsin in *State* v. *Nygaard*, 163 Wis. 307, 158 N. W. 87.

The decision of the Supreme Court of California also conflicts with opinions expressed by the Supreme Court of the State of Georgia (*Norman* v. *Bradley*, 173 Ga. 482, 160 S. E. 413, and *State Revenue Commission* v. *Lazear*, 179 Ga. 167, 175 S. E. 451), and the Supreme Judicial Court of Massachusetts (*Trefry* v. *Putnam*, 227 Mass. 522, 116 N. E. 904). The decisions in Wisconsin and Georgia arose in each case under the first personal income tax laws enacted in those States, and as to gains that had accrued prior to the applicable date of the respective laws they were held unconstitutional. Two situations were presented by the facts in the case of *Norman* v. *Bradley, supra,* but as to the gains on the sale of capital assets made after the applicable date and before the effective date of the law it was decided

that they were not taxable. The latter decision was followed in *State Revenue Commission* v. *Lazear*, 179 Ga. 167, 175 S. E. 451.

4. The opinion of the Supreme Court of the State of California in the above case is based upon a misconception and a misapplication by the court of the decisions of this Court concerning a Federal question, which misconception and misapplication should be corrected.

The cases of *Merchants Loan and Trust Company* v. *Smietanka*, 255 U. S. 509, 65 L. Ed. 751, and *Eisner* v. *Macomber*, 252 U. S. 189, 64 L. Ed. 521, upon which the California Supreme Court relies in its opinion in the instant case, do not support its conclusions, the former case holding only that capital increment accruing after the first Federal Revenue Act under the Sixteenth Amendment was taxable when realized, and the latter case holding only that stock dividends issued against accumulated profits of a corporation were not taxable as income. Neither these cases nor the case of *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 76 L. Ed. 1083, *supra*, support the proposition that an enhancement in value accruing before the effective date of the first establishment of a policy to tax income is subject to an income tax. There was no attempt in any of those cases to tax as income an enhancement of value accruing before March 1, 1913, the applicable date of the first Federal Income Tax Act enacted under the Sixteenth Amendment of the Constitution of the United States. They do not support the proposition that a state may constitutionally tax as income an enhancement of capital assets accruing before the first enactment by the State of an income tax act. Petitioner submits that to avoid the perpetuation of the California Supreme Court's misconception of the decisions of this Court it is necessary that this Court review the above cause.

Wherefore, your petitioner prays that this honorable Court grant its Writ of Certiorari directed to the Supreme Court of the State of California requiring a full and complete transcript of the record and of all proceedings of said Supreme Court of the State of California in said case to be duly certified to this Court, to the end that this Court proceed to correct the errors herein complained of, reverse the judgment of said Supreme Court of the State of California, and give to your petitioner such other and further relief as the nature of the cause may require and to this Court may seem meet and proper in the premises.

Los Angeles, California, May 16, 1941.

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